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MORTGAGE BANKING

MARCH 1990

THE MAGAZINE OF REAL ESTATE FINANCE

A Whirlwind of Reform

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COVER: Legislative Issues

The Congress got caught up in a whirlwind of reform last year after having to clean house in the thrift industry with the taxpayers footing the bill. The well publicized HUD scandals further fanned the fires of reform on Capitol Hill. As a result, all housing-related legislation is being scrutinized from a new vantage point with a much sterner grip on the federal housing purse strings.

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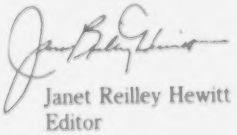
PORTFOLIO

Washington Watch

The "Keating Five," the S&L bailout price tag, Kemp and the GOP activist social agenda, the taxpayer's burden, HUD scandals, the Reagan Revolution and financial deregulation, the legacy of "Silent Sam," the health of the FHA insurance funds and potential budget vulnerability from the activities of the so-called government-sponsored entities (read FANNIE MAE, FREDDIE MAC AND GNMA). These are the key components that will shape the outlook for housing legislation in the months ahead. The individual spin that each legislator puts on these headlines and the connection between the events themselves in the eyes of elected representatives will be the foundation upon which housing policy will be forged in the near term.

The media plays a major role in connecting the news dots to paint the larger picture of cause and effect. To portray the powerful influence that the national news media has on lawmakers in Washington, our cover story revisits the making of the HUD reform act. This legislation was moved along by the powerful airwaves that brought the extent of lax management at HUD in certain program areas to the American T.V. audience almost daily last summer. The result was remedial legislation that moved so quickly through Congress it spun heads.

In this issue, we also focus on the opportunity that currently exists in Washington to pass important new housing legislation riding on the currents of activist change being fanned by a very dynamic and impassioned HUD secretary. Interestingly, if you dissect the different crosscurrents that are creating this legislative opportunity, it is a conservative Republican HUD secretary noted for preaching from the bible of private-sector solutions, along with a Roosevelt-style Democrat in the House, who will be the prime movers of any new housing legislation moved through Congress this year. Other key actors on the Senate side will be those under the shadow of the Charles Keating affair. Indeed, the S&L bailout and the mounting costs arising from that complete regulatory breakdown, just might prove the most influential player of all in the halls of Congress this year determining the key federal changes that will occur to help our nation become better housed.



Janet Reilley Hewitt
Editor

COMING IN APRIL

The dramatic boom in the wholesale mortgage banking business is reshaping the production side of the industry. Our lead story in April charts the rise in wholesale production during the last few pace-setting years. We will also run an interview with C. Austin Fitts, a new breed of manager at the helm of the FHA.

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Business and Editorial Offices
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Advertising (202) 861-6555
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ECONOMIC TRENDS

Although many would like to, few mortgage bankers can forget 1987, the industry's worst year in recent history. From the soaring profit margins of 1986, profits plunged to barely above zero in 1987 in the wake of declining origination volume and higher interest rates. Since then the industry has been working hard to contain costs and improve profitability. Recent evidence suggests that maybe, just maybe, the industry has turned the corner.

The evidence is the performance in the third quarter of 1989 of the 11 firms that responded to MBA's Ratio Analysis Survey (RAS) for this quarter and the third quarter of 1988. On average, between the third quarters of 1988 and 1989, these 11 firms increased productivity in origination and servicing, contained costs in these areas and improved overall profitability.

With the largest cost component of a mortgage banker's operation, personnel expenses, continuing to increase over the period (see accompanying Table), the firms in the sample continued their efforts to combat these rising costs by scaling down or consolidating their operations and, in some cases, changing their overall focus from predominantly retail to wholesale lending. Between the third quarter of 1988 and the third quarter of 1989, staffs at these 11 firms were cut by an average of eight employees per firm. The largest declines were in the origination function where the number of origination employees was slashed by an average of 35 employees per firm. Servicing staffs were also reduced, falling by an average of five employees per firm. However, firms in the sample partially offset these cutbacks in origination and servicing personnel by increasing their staffs in other areas of their operations, possibly in wholesale and correspondent lending functions.

In addition to reducing staff, firms have been integrating new technologies into their operations. This is particularly evident in the servicing function where firms have increased their use of computer applications for collections and quality control. The result has been a substantial increase in productivity and a concomitant decline in servicing costs. Between the third quarters of 1988 and 1989, the number of loans serviced per servicing employee rose 12 percent, or 86 loans, to 789. In turn, direct servicing costs per single-family loan serviced declined 16 percent over the course of the year to an annualized rate of $60.52. Data processing costs associated with servicing also fell over the course of the year, dropping 17 percent per loan serviced to an annualized rate of $9.04 in the third quarter of 1989.

Origination productivity also significantly increased over the period. The decline in origination staff, combined with a nearly 10 percent increase in the number of single-family loans closed, resulted in a 36 percent jump in the number of single-family loans closed per origination employee to 38 loans. Surprisingly, despite this significant jump in origination productivity, the direct origination cost per single-family loan closed was essentially unchanged from the previous year, averaging $1,469 in the third quarter of 1989. Because personnel expenses account for roughly two-thirds of direct origination costs, this suggests that employment costs per origination employee rose quite a bit faster than did employment costs per all employees.

Despite the stickiness of origination costs, two key measures of profitability increased substantially over the year. Return on average equity rose 85.4 percent to an annual rate of 12.68 percent, and return on average assets increased by 69.2 percent to an annual rate of 1.76 percent. However, as we have seen several times in the past year, much of the increase was due to large sales of servicing. Nevertheless, even without servicing sales, the trend in profitability over the last year has been clearly upward.

Obviously, 11 firms do not constitute the entire mortgage banking industry. However, the performance of these firms is heartening. We expect to see further evidence such as this in the months ahead as the fundamentals for the current year seem to favor mortgage banking. After an uptick in rates early this year, we expect interest rates to decline somewhat this Spring, fostering a modest increase in originations. Moreover, servicing operations are unlikely to suffer from unfavorable economic developments as a slight increase in the unemployment rate will most likely be offset by further modest gains in home prices, boosting homeowners' equity.

Does this mean that the worst is over for mortgage bankers? Maybe, although at this point it is difficult to say with certainty. But things do look better than they did in 1987.

Data from the RAS is quite useful in tracking current developments in the mortgage banking industry. Additional member firms that would like to participate in the quarterly survey are welcome. Reporting is relatively easy, and the results are routinely distributed shortly after the end of each quarter via the ECHO system or in a typed report. For further information, contact Rick Murray, programmer/analyst, MBA economics department, at (202) 861-1941.

Michelle V. Campbell
Economist

Mortgage Banking Industry Quarterly Cost, Productivity and Profitability Ratios (11 Firms)

	Third Quarter 1988	Third Quarter 1989	Percent Change
Cost Measures:			
Employment Cost Per Employee*	$31,684	$35,384	12%
Direct Cost of Servicing Single-Family Loan*	$ 72.12	$ 60.54	−16%
Direct Cost of Originating Single-Family Loan	$ 1,465	$ 1,469	0%
Productivity Measures:			
Single-Family Loans Serviced Per Servicing Employee	703	789	12%
Single-Family Loans Originated Per Origination Employee*	28	38	36%
Profitability Measures:			
Return on Average Equity*	6.84%	12.68%	85.4%
Return on Average Assets*	1.04%	1.76%	69.2%

*Annual Rate

VITAL STATISTICS

INTEREST RATES & YIELDS
1- TO 4-FAMILY MORTGAGES

	FHA OPINION SURVEY	FHLBB			FNMA		FHLMC	
		CONVENTIONAL[2]		Median Cost of Funds				
1989	FHA New Homes[1]	FRM	ARM	FSLIC Institutions	1-Yr. ARM	FRM Conv.	ARMs	FRMs
OCT	9.84%	10.37%	9.52%	8.01%	8.30%	9.81%	8.62%	9.95%
NOV	9.71	10.36	9.39	7.99	8.13	9.67	8.51	9.77
DEC	9.70	10.20	9.25	NA	8.00	9.67	8.39	9.74
1990 JAN	**NA**	**NA**	**NA**	**NA**	**8.20**	**9.90**	**8.39**	**9.90**

SELECTED SECURITIES

		PRIME COMMERCIAL PAPER	U.S. GOVERNMENT				
1989	FEDERAL FUNDS RATE	(3-Month)	6-Month	1-Year	3-Year	10-Year	A-Rated Utility
OCT	8.84%	8.53%	7.62%	7.99%	8.02%	8.01%	9.39
NOV	8.55	8.35	7.49	7.77	7.80	7.87	9.28
DEC	8.45	8.29	7.42	7.72	7.77	7.84	9.36
1990 JAN	**8.23**	**8.10**	**7.55**	**7.92**	**8.13**	**8.21**	**9.94**

CURRENT SECONDARY MARKET YIELDS

1989	GNMA[3]	FNMA[3]	FHLMC[3]
OCT	9.40%	9.42%	9.42%
NOV	9.26	9.31	9.31
DEC	9.26%	9.34%	9.32%
1990 JAN	**9.45**	**9.48**	**9.47**

SPREADS
(Basis Points)

1989	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
OCT	139	141	141
NOV	139	144	144
DEC	142	150	148
1990 JAN	**124**	**127**	**126**

SECONDARY MARKET ACTIVITY
(Dollars in Millions)

	FNMA				FHLMC				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
1989	Commitments	Purchases	Outstanding	Issued	Commitments To Sell	Commitments To Buy	Mortgages Purchased	PCs Issued	Applications	Issued
AUG	$2,842	$2,724	$203,923	$5,081	$7,851	$5,705	$7,283	$8,650	$6,161	$5,463
SEP	2,328	2,223	208,894	6,883	8,361	7,708	7,880	8,050	5,181	5,740
OCT	2,963	2,267	213,482	6,614	9,148	7,555	7,884	7,058	5,387	5,583
NOV	**2,536**	**2,376**	**220,118**	**8,720**	**8,112**	**10,948**	**7,653**	**7,059**	**4,408**	**5,823**
1988 TOTAL	23,435	23,110	---	54,878	41,271	70,660	44,075	39,777	58,578	56,531
1987 TOTAL	25,415	20,531	---	63,230	68,210	76,615	76,840	75,018	116,611	96,983
11 MONTH AVG. 1989	2,265	1,776	---	5,421	6,848	7,131	6,352	5,902	4,474	4,747
1988	2,008	1,944	---	4,495	3,217	5,506	3,476	3,115	4,978	4,698
1987	2,027	1,526	---	5,169	6,008	6,999	6,689	6,529	10,270	8,390

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES

(Units in Thousands, Seasonally Adjusted Annual Rates)

	BY TYPE OF UNIT						BY REGION							
	HOUSING STARTS			BUILDING PERMITS			HOUSING STARTS				BUILDING PERMITS			
1989	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Northeast	Midwest	South	West	Northeast	Midwest	South	West
SEP	1,264	1,028	236	1,319	1,012	307	161	248	486	369	170	254	509	386
OCT	1,423	1,083	340	1,356	1,025	331	173	285	567	398	172	276	492	416
NOV	1,342	1,050	292	1,342	1,043	299	180	297	488	377	171	275	496	400
DEC	**1,235**	**957**	**278**	**1,337**	**1,012**	**325**	**138**	**268**	**439**	**390**	**154**	**232**	**501**	**450**
1988 TOTAL	1,488	1,140	348	1,456	1,070	386	235	274	575	404	230	266	544	416
1987 TOTAL	1,621	1,212	409	1,535	1,114	421	269	298	634	420	272	282	575	406
12 MONTH AVG. (SAAR)														
1989	1,385	1,064	321	1,339	1,013	326	184	272	536	393	181	258	505	395
1988	1,494	1,146	348	1,451	1,080	371	242	274	573	405	237	268	540	406
1987	1,634	1,223	412	1,543	1,122	421	273	309	631	422	275	289	571	406

HOME SALES

(Units in Thousands)

	EXISTING HOMES			NEW HOMES		
1989	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate
SEP	3,520	2,320	7.9	640	364	7.1
OCT	3,480	2,170	7.5	637	364	7.0
NOV	3,590	2,420	8.1	696	365	6.4
DEC	**3,550**	**—**	**—**	**629**	**363**	**7.0**
1988 TOTAL	3,594	---	---	676	---	---
1987 TOTAL	3,526	---	---	671	---	---
12 MONTH AVG. (SAAR)						
1989	3,446	---	---	654	---	---
1988	3,594	---	---	675	---	---
1987	3,526	---	---	671	---	---

VALUE OF NEW PRIVATE CONSTRUCTION PUT IN PLACE

(Units in Billions of 1982 Dollars, Seasonally Adjusted Annual Rates)

Total[6]	1-Unit	2+ Units	Nonresidential
$274.5	$94.2	$19.0	$83.0
274.2	94.8	18.2	82.9
272.8	95.8	17.8	82.6
269.1	**96.5**	**17.4**	**79.2**
281.8	103.5	19.3	77.9
283.0	100.7	22.4	78.2
277.5	98.5	19.5	81.1
280.8	103.4	19.3	77.8
283.0	100.6	22.5	78.1

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Type of Unit
(Dollars in Millions)

	1-4 UNITS					5+ UNITS					NONRESIDENTIAL				
	Total[6]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[6]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[6]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies
1989															
JUL	$26,320	$5,522	$11,109	$9,262	$85	$1,746	$296	$676	$471	$175	$17,380	$135	$852	$14,270	$1,996
AUG	32,360	6,150	14,708	11,627	121	2,611	329	939	960	258	14,354	269	1,054	10,628	2,342
SEP	32,249	5,592	13,689	12,396	110	2,503	678	860	495	290	12,206	226	880	8,176	2,727
OCT	**31,928**	**5,496**	**13,922**	**12,012**	**171**	**3,130**	**275**	**953**	**1,125**	**407**	**14,783**	**6**	**920**	**11,353**	**2,366**
1988															
TOTAL	374,401	85,307	186,237	95,474	3,190	37,876	4,526	20,379	6,988	3,553	175,754	1,032	22,953	119,942	29,714
1987															
TOTAL	449,544	110,093	208,054	124,551	3,209	44,981	2,409	22,492	8,299	3,547	168,652	2,871	25,613	110,490	28,160
10 MONTH AVG.															
1989	28,988	5,484	12,995	10,022	95	2,549	320	1,101	691	217	12,749	126	1,248	9,278	1,965
1988	31,426	7,342	15,503	7,980	252	2,996	352	1,632	546	283	14,432	79	1,907	10,154	2,102
1987	39,288	9,806	19,565	10,953	287	3,880	216	1,874	709	284	13,382	268	2,060	8,816	2,129

MORTGAGE INSURANCE
(Units in Thousands, Dollars in Millions)

	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	TOTAL	FHA[8]	VA	PRIVATE	TOTAL		FHA		VA		PRIVATE	
					Units	Amount	Units	Amount	Units	Amount	Units	Amount
1989												
SEP	147	85	16	46	116	$8,981	68	$4,326	13	$1,033	35	$3,622
OCT	151	86	19	46	126	9,619	75	4,790	16	1,217	35	3,612
NOV	136	78	18	40	131	9,936	83	5,332	17	1,326	32	3,366
DEC	**116**	**62**	**16**	**38**	**102**	**7,971**	**55**	**3,542**	**15**	**1,193**	**32**	**3,236**
1988 TOTAL	1,755	949	211	595	1,334	98,012	699	42,577	211	15,771	424	39,664
1987 TOTAL	2,340	1,211	408	721	2,282	159,668	1,320	81,881	451	33,312	511	44,475
12 MONTH AVG.												
1989	141	83	16	42	106	8,091	61	3,824	15	1,171	30	3,094
1988	147	79	18	50	112	8,196	58	3,548	18	1,314	35	3,305
1987	195	101	34	60	203	14,179	110	6,823	38	2,776	43	3,706

NA—Not Available; SAAR—Seasonally Adjusted Annual Rate

[5]Secondary market gross yields. Numbers shown for each month are the average of yields from the first day of the month shown and the first day of the subsequent month.

[6]Effective rate on loans closed.

[7]Securities for 0- to 30-day delivery.

[8]In addition to the categories of private construction shown, the total also includes these categories: residential improvements, railroads, electric light and power, gas, telephone and telegraph, petroleum pipelines, and farm nonresidential.

[9]In addition to the categories shown, the total also includes private pension funds, private MBS conduits, state and local retirement funds, federal credit agencies, mortgage pools, and state and local investment agencies.

[7]Savings & Loans and Mutual Savings Banks.

[8]FHA applications received includes the Direct Endorsement Program.